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Elizabeth M. Orazem

Zoelsch v. Arthur Andersen & Co.: Restricting Subject Matter Jurisdiction for Foreign Litigants

The rapid internationalization in recent years of the U.S. securities market[1] has prompted a controversy among commentators and judges over the extent of the extraterritorial application of the antifraud provision of the Securities and Exchange Act of 1934 (1934 Act).[2] In *Zoelsch v. Arthur Andersen & Co.*[3] the U.S. Court of Appeals for the District of Columbia set forth the most restrictive test to date for determining the caliber of domestic conduct required to sustain subject matter jurisdiction in cases involving domestic conduct allegedly involved in the perpetration of a securities fraud on investors outside this country.[4] In an opinion by Judge Bork, the court held that federal subject matter jurisdiction exists only when the domestic conduct comprises all the elements necessary to establish a violation of section 10(b) and rule 10b-5.[5] This note examines the test de-

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[1] Between 1971 and 1981, foreign investment in the U.S. domestic market increased from $25.6 to $74 billion. *See* U.S. DEPT. OF COMMERCE, SURVEY OF CURRENT BUSINESS 56 (Aug. 1981); U.S. DEPT. OF COMMERCE, SURVEY OF CURRENT BUSINESS 21 (Aug. 1973). For a discussion of the increasing internationalization of U.S. securities markets, see Thomas, *Extraterritoriality in an Era of Internationalization of the Securities Markets: The Need To Revisit Domestic Policies*, 35 RUTGERS L. REV. 453, 453 (1983).

[2] The primary antifraud provisions are section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j (1982), and rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5 (1987).

For a discussion of the controversy, see Thomas, *supra* note 1, at 459-60 (presenting a conflict of law approach to subject matter jurisdiction when adjudicating transnational securities fraud cases); Note, *Predictability and Comity: Toward Common Principles of Extraterritorial Jurisdiction*, 98 HARV. L. REV. 1310, 1314-16 (1985) (advocating common jurisdictional standards for the extraterritorial application of the antifraud provisions).

[3] 824 F.2d 27 (D.C. Cir. 1987).

[4] *Id.* at 33.

[5] *Id.* Section 10 provides in pertinent part:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
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> . . . .
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> (b) To use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j (1982). Rule 10b-5 provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of material fact or to omit to state a ma-

vised by the court in *Zoelsch*, the reasoning underlying the court's test, and the variable effects of that test on judicial economy, capital formation in the United States, and the ability of the Securities and Exchange Commission (SEC) to police effectively domestic securities activities.

In *Zoelsch*, West German investors brought securities fraud claims against Arthur Andersen, an American accounting firm.[6] The investment concerned a tax shelter created by Loescher, a West German corporation, which would channel funds to a U.S. limited partnership based in Florida.[7] An audit report, distributed to the investors beforehand, was prepared by Arthur Andersen & Co. GmbH (GmbH), also a West German corporation.[8] Arthur Andersen was not directly involved in the solicitation of subject investors or in the preparation of any documents that induced securities purchases.[9] The only connection between Arthur Andersen and the alleged fraud was a reference suggesting that GmbH had consulted with Arthur Andersen regarding some of the data contained in the audit report.[10] Affirming the district court, the Court of Appeals for the District of Columbia failed to find a theory of liability in the complaint to support federal jurisdiction over the securities law claims.[11] Judge Bork adopted the Second Circuit terminology and concluded that the domestic activity was "merely preparatory" to any fraud perpetrated on the West German investors and did not "directly cause" their losses.[12] By adding the additional requirement that domestic conduct contain all the elements of a section 10(b) or rule 10b-5 violation, the court attempted to clarify the line between domestic conduct that is "merely preparatory" and conduct that "directly caused" the losses .[13]

According to the *Zoelsch* test, jurisdiction is appropriate when fraudulent statements or misrepresentations "originate in the United States, are made with scienter and in connection with the purchase

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terial fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading,

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (1987).

[6] *Zoelsch*, 824 F.2d at 28.

[7] *Id.*

[8] *Id.* GmbH is a separate corporate branch of Arthur Andersen. The investors brought a separate suit against GmbH in West Germany. *Id.*

[9] *Id.* at 29. The investors' complaint alleged that Arthur Andersen provided false and misleading information to GmbH knowing that this information would be used in GmbH's audit report and would be relied on by investors. *Id.*

[10] *Id.*

[11] *Id.* at 36.

[12] *Id.* at 35 (quoting Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 992-93 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975)).

[13] *Id.* at 30-31.

or sale of securities, and 'directly cause' the harm to those who claim to be defrauded, even if reliance and damages occur elsewhere."[14] The court reasoned that its test, a restatement of the Second Circuit's,[15] was more consistent with the congressional intent of the securities laws than tests adopted by other circuits.[16] The court criticized the policy approach used by other circuits in their jurisdictional analyses.[17] In assessing the jurisdictional theory proposed by the plaintiffs, the court concluded that the theory was "novel" and bore no relation to the Act's purpose or to tests employed in other circuit courts for determining jurisdiction.[18]

The provisions of the 1934 Act provide a broad grant of jurisdiction,[19] but the legislative history does not reveal the congressional intent regarding the Act's extraterritorial application.[20] Federal

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[14] *Id.* at 33. Judge Bork pointed out that standing to sue may limit extraterritorial jurisdiction. According to Judge Bork, the *Zoelsch* test "recognizes that the issue of federal jurisdiction over extraterritorial conduct . . . 'in no way depends on the merits of the plaintiff's contention that particular conduct is illegal . . . [but] often turns on the nature and source of the claim asserted.'" *Id.* at 33 n.4 (quoting Warth v. Seldin, 422 U.S. 490, 500 (1975)). In *Warth* the Court concluded that "the source of the plaintiff's claim to relief assumes critical importance with respect to the prudential rules of [judicial self restraint] that . . . serve to limit the role of the courts in resolving public disputes." 422 U.S. at 500. For a discussion of the doctrine of standing, see Logan, *Standing to Sue: A Proposed Separation of Powers Analysis*, 1984 WIS. L. REV. 37, 82 (concluding that the Court should allow Congress a greater role in defining standing by granting standing to virtually all plaintiffs asserting statutory claims unless the statute or its legislative history clearly supports a contrary conclusion); Shapiro, *Jurisdiction and Discretion*, 60 N.Y.U. L. REV. 543, 552-53 (1985) (arguing that the prudential aspect of the standing doctrine permits a court to exercise discretion in deciding whether to accord standing to a person seeking to assert another person's rights or raising a generalized grievance shared by a large class of citizens).

[15] *Id.* at 31.

[16] *Id.* at 31-32. The court stated: "Were it not for the Second Circuit's preeminence in the field of securities law, and our desire to avoid a multiplicity of jurisdictional tests, we might be inclined to doubt that an American court should ever assert jurisdiction over domestic conduct that causes loss to foreign investors." *Id.* at 32.

[17] *Id.* at 32-33. Judge Wald refused to accept the majority's rationale for rejecting the jurisdictional standards adopted by the Third, Eighth, and Ninth Circuits. *Id.* at 36 (Wald, J., concurring).

[18] *Id.* at 36.

[19] The Securities and Exchange Commission defines interstate commerce to include "trade, commerce, transportation or communication . . . between any foreign country and any State." 15 U.S.C. § 78c(a)(17) (1982). The federal district courts are given jurisdiction over suits brought to enforce the securities laws. *Id.* at § 78aa. Section 30(b) of the 1934 Act, however, provides that "[t]he provisions of this title . . . shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States . . . ." 15 U.S.C. § 78dd(b) (1983). Because this section provides a somewhat ambiguous mandate, courts often focus on the jurisdictional limits defined by international law. *See* Note, *supra* note 2, at 1314 & n.24.

[20] The reach of the 1934 Act is not apparent from its legislative history. *See Hearings on Stock Exchange Regulation Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 115 (1934); *Zoelsch*, 824 F.2d at 30 ("Congress did not consider how far American courts should have jurisdiction to decide cases involving predominantly foreign securities transactions with some link to the United States."); IIT v. Cornfeld, 619 F.2d 909, 912 n.2 (2d Cir. 1980) ("The SEC has not attempted to define the transnational scope of the anti-fraud provisions by any exercise of its rulemaking powers."); "Unfortunately, the legislative history is silent respecting the jurisdictional scope of the questions at issue

courts were without congressional guidance when confronted with domestic conduct allegedly involved in the perpetration of a securities fraud on investors outside the United States. As a result, the circuit courts developed two tests for jurisdiction.[21] In *Schoenbaum v. Firstbrook*[22] the court sustained jurisdiction based on an effects test.[23] The court held that subject matter jurisdiction existed when the transactions involve stock registered and listed on a national securities exchange and when the failure to extend jurisdiction will detrimentally affect the interests of U.S. investors.[24]

The Second Circuit also fashioned a conduct test as a basis for extraterritorial application of the federal securities laws in *Leasco Data Processing Equipment Corp. v. Maxwell.*[25] In *Leasco* a foreign investor, a wholly-owned American subsidiary, brought suit alleging a rule 10b-5 violation against a foreign corporation.[26] The plaintiff

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here." SEC v. Kasser, 548 F.2d 109, 114 n.21 (3d Cir.), *cert. denied*, 431 U.S. 938 (1977); Murano, *Extraterritorial Application of the Antifraud Provisions of the Securities Exchange Act of 1934*, 2 INT'L TAX & BUS. LAW 298, 300 (1984) ("the securities laws offer little explicit guidance as to their transnational applicability"); Thomas, *supra* note 1, at 455-59 (discussing the "dearth" of legislative history and the tests set forth in the case law for asserting subject matter jurisdiction in transnational fraud cases).

[21] *See* Grunethal GmbH v. Hotz, 712 F.2d 421, 424 (9th Cir. 1983) (limiting jurisdiction to the perpetration of fraudulent acts and refusing jurisdiction when the domestic activity was "merely preparatory" and the bulk of activity occurred abroad); *Cornfield*, 619 F.2d at 920-21 (the determination of whether to extend jurisdiction depends on the amount of domestic conduct compared to the amount of conduct abroad); Continental Grain v. Pacific Oilseeds, Inc., 592 F.2d 409, 420 (8th Cir. 1979) (granting jurisdiction when the defendants' domestic conduct was in furtherance of a fraudulent scheme, was significant with respect to its accomplishment, and involved the use of the mails and other instrumentalities of interstate commerce); *Kasser*, 548 F.2d at 114 (application of the U.S. antifraud provisions is proper "where at least some activity designed to further a fraudulent scheme" occurs domestically); IIT v. Vencap, Ltd., 519 F.2d 1001, 1018 (2d Cir. 1975) ("jurisdiction is limited to the perpetration of fraudulent acts themselves and does not extend to mere preparatory activities or the failure to prevent fraudulent acts where the bulk of the activity was performed in foreign countries . . . ."); Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 993 (2d Cir.) (restricting jurisdiction for foreign litigants to cases in which domestic conduct directly causes the losses from the sale of securities), *cert. denied*, 423 U.S. 1018 (1975); Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1334 (2d Cir. 1972) (concluding that the 1934 Act was intended to protect against fraud in the sale or purchase of securities whether or not they are traded on national markets and the 1934 Act is applicable to transactions in foreign securities consummated abroad when fraudulent acts occurred domestically).

[22] 405 F.2d 200 (2d Cir.), *partially rev'd on other grounds*, 405 F.2d 215 (1968), *cert. denied*, 395 U.S. 906 (1969).

[23] *Id.* at 208. *Schoenbaum* involved U.S. investors who purchased foreign securities on U.S. securities exchanges. *Id.* at 204-05. The court was concerned with protecting U.S. securities markets from the effects of fraudulent foreign transactions in U.S. securities. *Id.* at 208-09.

[24] *Id.* The effects test is not applicable here because neither U.S. securities nor investors were involved. The plaintiffs relied on Arthur Andersen's domestic conduct as the basis for jurisdiction. Zoelsch v. Arthur Andersen & Co., 824 F.2d 27, 30 (D.C. Cir. 1987).

[25] 468 F.2d 1326 (2d Cir. 1972).

[26] *Id.* at 1337. Because the plaintiff was a wholly-owned American subsidiary, the Second Circuit analyzed jurisdiction as if the litigation involved a domestic plaintiff and a foreign defendant. *Id.* at 1338.

purchased a security not registered with the SEC, and the sale occurred abroad. The plaintiff alleged, however, that the purchase was induced by conduct in the United States consisting of communications by mail and telephone, and in person.[27] The court held that the 1934 Act was intended to protect against fraud in the sale or purchase of securities, whether or not the securities were traded on organized U.S. markets. The court also held that jurisdiction was available when a defendant's fraudulent acts took place within the United States.[28]

The Second Circuit took the *Leasco* analysis further in *Bersch v. Drexel Firestone, Inc.*,[29] holding that the kind of conduct necessary for a finding of jurisdiction varies depending on whether or not the plaintiff is a U.S. citizen.[30] According to the court, U.S. securities laws "[d]o not apply to losses from sales of securities to foreigners outside the United States, unless acts (or culpable failures to act) within the United States directly caused such losses."[31] The Second Circuit later limited the domestic conduct sufficient to sustain juris-

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[27] *Id.* at 1331.

[28] *Id.* at 1335-37. According to the court's decision, jurisdiction premised on a conduct analysis should be determined by comparing the domestic and foreign conduct. *Id.* at 1337. The court, however, indicated that to extend jurisdiction, the fraudulent conduct and misrepresentations that induced the foreign purchase must occur domestically. The court stated:

> [W]e must ask ourselves whether, if Congress had thought about the point, it would not have wished to protect an American investor if a foreigner comes to the United States and fraudulently induces him to purchase foreign securities abroad—a purpose which its words can fairly be held to embrace. While as earlier stated, we doubt that impact on an American company and its shareholders would suffice to make the statute applicable if the misconduct had occurred solely in England, *we think it tips the scales of applicability when substantial misrepresentations were made in the United States.*

Id. at 1337 (emphasis added).

In its attempt to define the jurisdictional boundaries of the antifraud provisions, the court relied on section 17 of the Second Restatement of Foreign Relations Law of the United States. *Id.* The section, which is entitled "Jurisdiction to Prescribe with Respect to Conduct, Thing, Status, or Other Interest within Territory," states that:

> A state has jurisdiction to prescribe a rule of law
> (a) attaching legal consequences to conduct that occurs within its territory, whether or not such consequences are determined by the effects of the conduct outside the territory, and
> (b) relating to a thing located, or a status or other interest localized in its territory.

RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 17 (1965).

[29] 519 F.2d 974 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975).

[30] *Id.* at 993. In *Bersch*, a U.S. citizen brought a class action on behalf of himself and other investors against a foreign corporation for securities fraud. The plaintiff class consisted of U.S. residents both in the United States and abroad and foreign residents abroad. *Id.* at 978-84. In establishing different standards for foreign and domestic investors, the court expressed its desire to conserve U.S. administrative resources and its sensitivity to issues of comity and fairness. *Id.* at 985.

[31] *Id.* The court also held that the federal securities laws applied to sales of securities to American residents in the United States whether or not acts of material importance occurred in the United States and to American residents abroad only if acts of material importance in the United States significantly contributed to such losses. *Id.*

diction to the perpetration of "fraudulent acts themselves" rather than "mere preparatory activities."[32] The *Bersch* court, however, reasoned that when a court is "confronted with transactions that are on any view predominantly foreign, it must seek to determine whether Congress would have wished" that U.S. securities laws applied or whether the case could be adjudicated better in another forum.[33]

In *IIT v. Cornfield,*[34] the most recent Second Circuit decision addressing extraterritorial application of the Securities and Exchange Act, the court granted jurisdiction in an action by a foreign investment trust and its liquidators against U.S. defendants.[35] The domestic conduct in *Cornfield* consisted of improper accounting work and the drafting of an allegedly fraudulent prospectus.[36] The court avoided establishing a definitive test and stated that no single factor would be dispositive in future cases. Rather, the court used a balancing approach in assessing the sufficiency of conduct necessary to sustain subject matter jurisdiction.[37] According to the court, the determination of whether the domestic activities *directly* caused the foreigners' losses depended on the amount of domestic activity relative to the amount of foreign activity.[38] While both *Cornfield* and *Bersch* involved similar jurisdictional variables,[39] the court in *Cornfield* distinguished its jurisdictional determination.[40] The court stressed that the domestic conduct in *Bersch* was merely preparatory, in contrast to the foreign conduct, which comprised the final and critical conduct. Although the domestic conduct in *Cornfield* was also prepar-

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[32] IIT v. Vencap, Ltd., 519 F.2d 1001, 1018 (2d Cir. 1975). *Vencap* involved an action brought by a foreign investment trust for fraud, conversion, and corporate waste against a foreign corporation and other individual defendants. *Id.* at 1004-11. The court concluded that the federal court had subject matter jurisdiction over a suit under the federal securities laws for damages or rescission by a defrauded foreign individual. *Id.* at 1017. The court stated: "We do not think Congress intended to allow the United States to be used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners." *Id.*

[33] *Bersch*, 519 F.2d at 985.

[34] 619 F.2d 909 (2d Cir. 1980).

[35] *Id.* at 919-21. The Second Circuit regarded the predominantly foreign fundholders as the real party in interest and the American aiders and abetters, including Arthur Andersen, as the true defendants. *Id.* at 918.

[36] *Id.* at 918-21.

[37] *Id.* The court stated:

> It should be evident by now that "the presence or absence of any single factor which was considered significant in other cases dealing with the question of federal jurisdiction in transnational security cases is not necessarily dispositive" in future cases. Hence we do not mean to suggest that either the American nationality of the issuer or consummation of the transaction in the United States is either a necessary or a sufficient factor, but rather the presence of both these factors points strongly toward applying the anti-fraud provisions of our securities laws. *Id.* at 918 (quoting Continental Grain v. Pacific Oilseeds, Inc., 592 F.2d 409, 414 (8th Cir. 1979)).

[38] *Id.* at 920-21.

[39] Both cases involved foreign plaintiffs, domestic defendants, purchases abroad, and effect abroad.

[40] *Cornfield*, 619 F.2d at 920.

atory, the court pointed out that there was no foreign counterpart. The domestic conduct in *Cornfield*, therefore, was the sole and direct cause of the loss.[41]

Like the Second Circuit, the Third and Eighth circuits assert jurisdiction only when the domestic conduct directly causes the losses elsewhere.[42] In contrast to the Second Circuit, these courts require a lesser degree of domestic conduct to assert a claim under the U.S. securities laws.[43] These circuits have based adoption of a more liberal jurisdictional standard on policy considerations consistent with the perceived congressional intent of the antifraud provisions.[44]

The Third Circuit in *SEC v. Kasser*[45] held that the federal securities laws granted jurisdiction in transnational fraud cases "where at least some activity designed to further a fraudulent scheme" occurred domestically.[46] The court adopted dicta of the Second Circuit and argued that Congress did not intend to prohibit the SEC from policing fraudulent securities activities within the United States, even when the securities were sold only to foreigners.[47] In determining whether the domestic conduct was sufficient to extend jurisdiction, the court looked at the quantity of the defendants' domestic activities and concluded that the domestic conduct was crucial

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[41] *Id.* The court stressed the lack of foreign activity in *Cornfield* which was "so dominant in *Bersch*." As for the accounting work performed in both cases, the court in *Cornfield* noted that there was some domestic accounting work in *Bersch*, but that in *Cornfield* all the accounting work was and had to be done in the United States. *Id. See* Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 989 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975).

[42] *See* Grunethal GmbH v. Hotz, 712 F.2d 421, 424 (9th Cir. 1983); Continental Grain v. Pacific Oilseeds, Inc., 592 F.2d 409, 420 (8th Cir. 1979) (conduct in the United States must be material and directly cause losses rather than merely preparatory); SEC v. Kasser, 548 F.2d 109, 115 (3d Cir.) (discussing whether the losses were directly caused by the acts of the defendants within the United States), *cert. denied*, 431 U.S. 938 (1977).

[43] *See Grunethal GmbH*, 712 F.2d at 424-25; *Continental Grain*, 592 F.2d at 421 (federal securities laws grant jurisdiction in transnational securities cases in which the domestic conduct was in furtherance of a fraudulent scheme and was significant with respect to its accomplishment); *Kasser*, 548 F.2d at 114 (federal securities laws grant jurisdiction in transnational securities cases "where at least some activity designed to further a fraudulent scheme" occurred domestically).

[44] *See Grunethal GmbH*, 712 F.2d at 424 ("the test used by the Third [*Kasser*] and Eighth [*Continental Grain*] Circuits advances the policies underlying federal securities laws"); *Continental Grain*, 592 F.2d at 421-22 ([T]he "general purpose of the securities laws" is to "mandate the highest standards of conduct in securities transactions."); *Kasser*, 548 F.2d at 116 ("[T]he antifraud provisions of the 1933 and the 1934 Acts were designed to insure high standards of conduct in securities transactions within this country in addition to protecting domestic markets and investors from the effects of fraud"). *See also* United States v. Cook, 573 F.2d 281, 283-84 (5th Cir. 1978) ("It is an absurd notion that Congress intended activity in the United States involving American securities to be exempt from the fraud provisions of the securities acts simply because the victims are not American citizens.").

[45] 548 F.2d at 109.

[46] *Id.* at 114. *Kasser* involved an action brought by the SEC against foreign individuals and corporations based on an alleged scheme to defraud a foreign corporation. *Id.* at 110-12.

[47] *Id.* at 113-14.

to the consummation of the fraud.[48] Realizing that extraterritorial jurisdiction called for a policy decision, the court proposed three policy rationales for sustaining jurisdiction.[49]

Moreover, the Eighth Circuit granted jurisdiction in *Continental Grain v. Pacific Oilseeds, Inc.*,[50] in which the only domestic conduct consisted of telephone calls and letters.[51] Citing *Kasser*, the court stated that the federal securities laws grant jurisdiction in transnational securities cases when at least some activity designed to further a fraudulent scheme occurred domestically.[52] The court admitted that its decision to grant jurisdiction was "largely a policy decision" supported by the antifraud provisions, which evidence congressional intent for a broad jurisdictional scope.[53]

Purportedly following the Second Circuit, the *Zoelsch* court established a "litmus test"[54] for determining what domestic conduct serves as a jurisdictional predicate under the securities laws for investors outside the United States.[55] The litmus test, adopted from *Bersch*, added the 10b-5 requirement.[56] In the two cases following *Bersch*, however, the Second Circuit did not expressly distinguish between preparatory conduct and conduct directly causing the damage abroad or explicitly establish a test requiring the domestic conduct to contain all the elements of a section 10(b) violation.[57] Quoting

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[48] *Id.* at 115. The court stated: "Not only do we believe that the sum total of the defendants' intranational actions was substantial, but we also question whether it can be convincingly maintained that such acts within the United States did not directly cause any extraterritorial losses. . . . [I]t is evident that the defendants' conduct occurring within the borders of this nation was essential to the plan to defraud the Fund." *Id.*

[49] *Id.* at 116. The court stated that a denial of jurisdiction "may embolden those who wish to defraud foreign securities purchasers or sellers to use the United States as a base of operations" and may invite reciprocal responses in other countries. On the other hand, the assertion of jurisdiction would "enhance the ability of the SEC to police vigorously" securities activities within the United States. *Id.*

[50] 592 F.2d 409 (8th Cir. 1979).

[51] *Id.* at 420.

[52] *Id.* The court, however, refused to deviate from the language of the Second Circuit in *Vencap* and *Bersch* and stated that the domestic conduct cannot be merely preparatory and must directly cause the losses. According to the court: "finding subject matter jurisdiction after such an analysis is consistent with the subjective territorial principle of international law, the intent of Congress and the remedial purpose of the federal securities laws." *Id.*

[53] *Id.* at 421. The court does not go so far as to say that Congress intended the antifraud provisions to apply extraterritorially when the domestic conduct is insubstantial. The court, however, argued that the "range of significant conduct should . . . be fairly inclusive. This is consistent with the general purpose of the securities laws to mandate the highest standards of conduct in securities transactions." *Id.*

[54] *See* Morgenstern, *Extraterritorial Application of United States Securities Law: A Matrix Analysis*, 7 HASTINGS INT'L & COMP. L. REV. 1, 31 n.111 (1983).

[55] *Zoelsch*, 824 F.2d at 33.

[56] *See id.*

[57] The court does not cite any cases distinguishing between preparatory conduct and conduct directly causing the losses. From the opinion, however, it may be inferred that the court was referring to *Cornfield*. In *Cornfield*, the court clearly was hesitant to establish a definite test. The court stated:

the Eighth Circuit's decision in *Continental*, the court in *Cornfield* refused to establish a definitive test.[58] Rather, the determination of the jurisdictional sufficiency of domestic conduct depended on the amount of domestic activity relative to the amount of foreign activity.[59] The Second Circuit in *Cornfield* held that preparatory domestic conduct was a sufficient jurisdictional predicate when there was no foreign counterpart and when the preparatory domestic conduct was the sole and direct cause of the losses.[60]

In addition to citing the Second Circuit as the basis for its jurisdictional test, the *Zoelsch* court contended that its test was more consistent with the congressional intent regarding the scope of the U.S. securities laws than the more liberal approaches employed by other circuits.[61] The court argued that these less restrictive jurisdictional standards were essentially legislative policy considerations.[62] According to the court, the salient analysis was to determine what "jurisdiction Congress in fact thought about and conferred" when drafting the 1934 Act, rather than "divining what 'Congress would have wished.' "[63] In analyzing congressional intent, the court stated the presumption, employed in other contexts, that "Congress is primarily concerned with domestic conditions."[64] The court further argued that it was "quite clear" from the congressional debates before the enactment of the 1934 Act and from section 30(b)[65] of the 1934 Act that Congress was concerned with extraterritorial transactions only if "they were part of a plan to harm American investors and

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> [W]e do not mean to suggest that either the American nationality of the issuer or consummation of the transaction in the United States is either a necessary or sufficient factor . . . but rather that the presence of both these factors points strongly toward applying the anti-fraud provisions of our securities laws.

IIT v. Cornfield, 619 F.2d 909, 918 (2d Cir. 1980).

Moreover, the court in IIT v. Vencap, Ltd., 519 F.2d 1001, 1018 (2d Cir. 1975), went no further than to limit its basis of jurisdiction to "the perpetration of fraudulent acts themselves." *Id.* The Second Circuit has not interpreted the language in *Vencap* to require that the domestic conduct contain all the elements of a rule 10b-5 violation, but at least one district court has made this interpretation. *See* FOF Proprietary Funds, Ltd., v. Arthur Young & Co., 400 F. Supp 1219, 1222-23 (S.D.N.Y. 1975).

[58] *See Cornfield*, 619 F.2d at 918.

[59] *Id.* at 920-21. According to the court, the "[d]etermination whether American activities 'directly' caused losses to foreigners depends not only on how much was done in the United States but also on how much (here how little) was done abroad." *Id.*

[60] *Id.* at 920.

[61] *Zoelsch*, 824 F.2d at 31-33.

[62] *Id.* at 32-33. Judge Wald, in his concurring opinion, argued that the decisions cited by the court as examples of judicial lawmaking clearly indicated that the "policies adopted are those the court perceives as most consistent with the intent of Congress." *Id.* at 37 (Wald, J., concurring).

[63] *Id.* at 32.

[64] *Id.* at 31.

[65] Section 30(b) provides that "[t]he provisions of this title . . . shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States . . . ." 15 U.S.C. § 78dd(b) (1983).

markets."[66]

Judge Bork's congressional intent analysis[67] was inconsistent with his earlier statement that Congress did not consider the scope of the extraterritorial jurisdiction of the securities laws.[68] The court stated that the inquiry required the "unavoidable task of discerning a purely hypothetical legislative intent."[69] The court also alluded to the relatively "barren" text and legislative history of the 1934 Act and cited several provisions that framed "a fairly broad grant of jurisdiction."[70] Judge Bork also noted that section 78c(a)(17) of the 1934 Act broadly defined interstate commerce to include " 'trade, commerce, transportation, or communication . . . between any foreign country and any State.' "[71]

The court added that a more restrictive test would have the desirable effect of preserving judicial and law enforcement resources for domestic affairs.[72] The court dismissed the jurisdictional tests devised in the Third and Eighth circuits as essentially legislative decisions.[73] *Kasser* and *Continental*, however, clearly indicate a desire to further policies consistent with congressional intent of the antifraud provisions.[74] Moreover, the Second Circuit suggested that allowing the SEC to police fraudulent securities activities within the United States, even when the securities were only sold to foreigners, was a policy objective consistent with the intent of the enactors of the 1934 Act.[75]

The court's purported adoption of the Second Circuit test demonstrates a lack of sympathy for the plaintiffs' alternative theory of jurisdiction.[76] Under the investors' test for finding jurisdiction, activity that surrounds any given securities transaction should be considered as a single mass, and subject matter jurisdiction should be asserted if the sum of domestic activities by all participants in a string of transactions seems large enough to support jurisdiction in the federal courts.[77] Rejecting this contention, the court concluded that the investors' jurisdictional test was "novel" and bore no relation to any

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66 Zoelsch v. Arthur Andersen & Co., 824 F.2d 27, 31-32 (D.C. Cir. 1987).

67 *Id.*

68 *Id.* at 30.

69 *Id.*

70 *Id.*

71 *Id.*

72 *Id.* at 32. The court quoted Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 985 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975), in a parenthetical that reads: [w]hen . . . a court is confronted with transactions that on any view are predominantly foreign, it must seek to determine whether Congress *would have wished the precious resources of the United States courts and law enforcement agencies to be devoted to them rather than leave the problem to other countries. Id.* (emphasis added.)

73 Zoelsch v. Arthur Andersen & Co., 824 F.2d 27, 32-33 (D.C. Cir. 1987).

74 *See* cases cited *supra* note 43.

75 *See* IIT v. Vencap, Ltd., 519 F.2d 1001, 1018 (2d Cir. 1975); *see also supra* note 35.

76 *Zoelsch*, 824 F.2d at 36.

77 *Id.*

of the tests for determining jurisdiction based on domestic conduct adopted by any of the federal appellate courts.[78]

Judge Bork's conclusion that the quantitative jurisdictional theory proposed by the plaintiff in *Zoelsch* was "novel" does not square with decisions from the Third and Eighth Circuits.[79] In *Kasser* the Third Circuit emphasized that the quantity rather than the quality of domestic activity should be considered in determining the jurisdictional sufficiency of domestic conduct.[80] Similarly, the Second Circuit in *Cornfield* concluded that the determination of whether the American activities directly caused the losses to foreigners depends on the amount of domestic activity relative to the amount of foreign activity.[81] In contrast to *Zoelsch*, *Kasser* and *Cornfield* strongly suggest the appropriateness and validity of a quantitative analysis.

Several desirable consequences may flow from the restrictive parameters of the *Zoelsch* test, including a reduced reliance by other nations on U.S. regulation of international securities fraud. Courts adopting the *Zoelsch* test will be more hesitant to extend jurisdiction in securities fraud cases involving foreign litigants.[82] More stringent jurisdictional standards may encourage foreign governments to regulate securities activities in their countries, allowing U.S. judicial and law enforcement officials to concentrate on domestic or predominantly domestic disputes.[83]

In the long run, however, the restrictive nature of the test may produce significant adverse effects. Restricting subject matter jurisdiction for foreign litigants could send a signal to foreign investors that claims of fraudulent conduct that occurs only partly in the United States may not be adjudicated in U.S. courts. As a result, foreign investors may choose not to invest their funds in the United States or in securities schemes involving U.S. participants.[84] In addi-

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[78] *Id.*

[79] *See* SEC v. Kasser, 549 F.2d 109, 115 (3d Cir.) (the "sum total" of the defendant's actions within the United States must be considered before granting or denying jurisdiction based on domestic conduct), *cert. denied*, 431 U.S. 938 (1977); Note, *Expanding The Jurisdictional Basis For Transnational Securities Fraud Cases: A Minimal Conduct Approach*, 6 FORDHAM INT'L L.J. 308, 321 n.84 (1983).

[80] *Kasser*, 548 F.2d at 115.

[81] *Cornfield*, 619 F.2d at 920-21; *see also supra* note 59.

[82] *See generally* E. NEREP, EXTRATERRITORIAL CONTROL OF COMPETITION UNDER INTERNATIONAL LAW 551-55 (1983) (describing nonintervention as a fundamental principle protecting the sovereignty of nations).

[83] *See* Zoelsch v. Arthur Andersen & Co., 824 F.2d 27, 32 (D.C. Cir. 1987); Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 985 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975). Whether the employment of the court's test in *Zoelsch* would significantly deter foreign litigants from bringing their securities fraud claims in U.S. courts is not clear. Furthermore, law enforcement agencies will have to police domestic conduct with the employment of any test. The stringent standards may encourage more fraudulent activity in the United States. Law enforcement officials and courts, therefore, may find themselves devoting more resources to fraudulent securities activities in the United States.

[84] Thomas, *supra* note 1, at 453-54; Note, *American Adjudication of Transnational Securities Fraud*, 89 HARV. L. REV. 553, 570 (1976).

tion, if other countries perceive U.S. jurisdictional policy as unfair and unnecessarily restrictive, they may respond with countermeasures that could impede the free flow of investment capital in the international marketplace.[85] Possible countermeasures include the employment of more restrictive jurisdictional standards for securities fraud and similar claims brought in foreign forums, or the refusal to act at all against defrauders seeking to transport securities fraud to the United States.[86] The refusal to grant jurisdiction when some conduct took place in the United States and the defrauders used the name of a reputable American accounting firm in its prospectus could undermine the power of the SEC to monitor effectively securities activities in the United States.[87]

Furthermore, several commentators and judges detect a potential constitutional problem with the employment of different jurisdictional standards for foreign and American plaintiffs.[88] The employment of stricter jurisdictional standards for foreign litigants than for American litigants arguably constitutes a denial of due process under the equal protection guarantee of the fifth amendment to the Constitution.[89] Such discrimination may also conflict with U.S. treaty commitments seeking to give citizens of certain countries and resident U.S. citizens equal judicial treatment.[90]

The reasoning and logic behind the court's decision to employ a restrictive jurisdictional test are unpersuasive. The court took the jurisdictional tests devised by the Second Circuit a step further by requiring more domestic activity for foreign litigants before a U.S. district court can extend subject matter jurisdiction in transnational fraud cases. Only the strongest claims can be heard. This analysis suggests that the test is not a product of an interpretation of the ju-

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[85] Note, *supra* note 2, at 1311 n.6, 1321.

[86] SEC v. Kasser, 548 F.2d 109, 116 (1977) (granting jurisdiction may encourage other states to act against defrauders who seek to perpetrate frauds in the United States). *But see* von Mehun, *Adjudicatory Jurisdiction: General Theories Compared and Evaluated*, 63 B.U.L. REV. 279, 285-87 (1983) (providing examples of retaliatory measures taken in response to the United States exercise of extraterritorial jurisdiction).

[87] Note, *supra* note 84, at 570.

[88] *See* Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1334 (2d Cir. 1972) (courts are bound to follow the congressional direction unless doing so would violate the due process clause of the fifth amendment); Morgenstern, *supra* note 54, at 21 n.74 ("Refusal to find subject matter jurisdiction as to an alien when jurisdiction would exist for an American may constitute a denial of due process under the equal protection guarantee of the fifth amendment of the Constitution"). *But cf.* Matthews v. Diaz, 426 U.S. 67, 77 (1976) (concluding that a medicare supplemental medical insurance program denying eligibility to aliens unless they have been admitted for permanent residence in the United States for five years does not violate the due process clause); Patel v. Sumani Corp., 660 F. Supp. 1528, 1531 (N.D. Ala. 1987) (holding that an illegal alien may be a person guaranteed equal protection and due process of law, but was not an individual within the definition of employee under the Fair Labor Standards Act and thus had no standing to sue).

[89] *Id.*

[90] Note, *supra* note 84, at 570.

risdictional scope of the 1934 Act or of a desire to follow the guidance of the Second Circuit. The court ignored the Second Circuit's jurisdictional approach in *Cornfield* and dismissed the Third and Eighth Circuit precedent that supported the validity of the jurisdictional theory set forth by the *Zoelsch* plaintiffs. The court appears to have based its restrictive approach on policy objectives and judicial conservatism.[91] The *Zoelsch* panel rejected the reasoning of other circuits because these courts were persuaded by policy considerations. At the same time, Judge Bork proposed a policy reason to justify his own analysis.

Moreover, no authority supports the argument that the employment of the jurisdictional approach in *Zoelsch* will preserve effectively the judicial resources of the United States. The United States has an interest in adjudicating claims in which defrauders use the name of a reputable American accounting firm, such as Arthur Andersen, in connection with the sale of securities.[92] Reference to an American corporation could mislead investors into believing that their investments are protected by U.S. securities laws.[93] Thus, in the long run, the adoption of the *Zoelsch* test as the criterion for subject matter jurisdiction for foreign litigants may impede the free flow of investment capital to the United States. In effect by refusing to grant jurisdiction in cases involving some fraudulent conduct in the United States, courts will hinder SEC regulation of securities activities within the United States—an objective foremost in the minds of the enacters of the 1934 Act.

ELIZABETH M. ORAZEM

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[91] The opinion indicated that the court was concerned not only with preserving judicial and law enforcement resources for domestic disputes, but also about the lack of uniform standards for subject matter jurisdiction for foreign litigants. Zoelsch v. Arthur Andersen & Co., 824 F.2d 27, 32 (D.C. Cir. 1987). Judge Bork also asserted that considerations of "comity" were not significant in *Zoelsch*. *Id.* at 31. State sovereignty, however, is relevant in a securities fraud case involving foreign plaintiffs and a foreign corporation. Every assertion of extraterritorial jurisdiction encroaches upon the sovereignty of another national government. Note, *supra* note 2, at 1310 & n.1.

[92] The United States has an interest in discouraging other "potential perpetrators of fraud from taking advantage of American resources and prestige." Note, *supra* note 84, at 570.

[93] *Id.*